The Pakistan Credit Rating Agency Limited

Rating Report

Ellcot Spinning Mills Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Sep-2024	A-	A2	Stable	Maintain	-
22-Sep-2023	A-	A2	Stable	Maintain	-
23-Sep-2022	A-	A2	Stable	Maintain	-
24-Sep-2021	A-	A2	Stable	Maintain	-
25-Sep-2020	A-	A2	Stable	Maintain	-
28-Sep-2019	A-	A2	Stable	Maintain	-
30-Mar-2019	A-	A2	Stable	Maintain	-
28-Dec-2018	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The assigned rating of Ellcot Spinning Mills Limited ("the Company" or "ESML") reflects the prominent profile of its sponsoring group - Nagina Group, one of the oldest medium-sized textile groups in Pakistan. Three publicly listed Companies primarily operate under the umbrella of the Nagina Group. The Group operates in the spinning sector via Nagina Cotton Mills Limited (NCML) and ESML and in the weaving sector through Prosperity Weaving Mills Limited (PMWL). The rating takes comfort from the consolidated financial strength of the sponsoring group. The Company has achieved capacity utilization of 100.0% with a production capacity of ~16.5mln Kgs. The company's product slate includes pure cotton and polyester cotton. The Company has a total energy requirement of 8.33MW, primarily met through gas generators. ESML has already installed a 1MW solar power plant and is in the process of installing an additional 1.4MW via utilizing conventional borrowings to manage escalated energy cost risk. There is a strategic shift in Nagina group's yarn production strategy by moving from 20/s count to 18/s count yarn production (more coarse yarn count) to meet customers' demands and it contributed as a set forth factor behind volumetric growth in sales coupled with execution of CAPEX via the installation of ~16,800 new spindles during FY23. During 9MFY24, the Company achieved a topline of PKR 11.4bln (FY23: PKR 12.2bln) with a for-the-period growth of 32%; mainly driven by volumetric impact as shifting towards coarse yarn production has reduced per Kg product price. Exports constitute 15% of the total revenue in 9MFY24. During 9MFY24, approximately 44.0% of local sales were dedicated to the group company, PMWL. The Company's top clientage includes prominent players. The Company recorded a net profitability of PKR 54mln during 9MFY24 (9MFY23: 335mln). The margins of the Company have been impacted by expensive raw material procurement, rising energy tariffs, and magnifying financial costs. The Company's financial risk profile is considered moderate as ESML aptly managed their working capital management via optimizing inventory levels which rationalizes the requirement of short-term borrowings and creates a cushion in short-term trade leverage. However, the Company has witnessed a decline in coverages, owing to high finance costs, adequate cashflows and a dip in the profitability matrix. The Company has maintained a leveraged capital structure with long-term borrowings dominated by subsidized borrowing from SBP.

The ratings are dependent on the Company's ability to increase business margins through operational efficiencies and product quality. The sustainability of cashflows and coverages at a comfortable level remains critical for the ratings. Going forward, consistent growth in accumulated profits should supplement the equity levels.

Disclosure

Name of Rated Entity	Ellcot Spinning Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-24),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-24)
Related Research	Sector Study | Spinning(Sep-23)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@pacra.com | +92-42-35869504

Profile

Legal Structure Ellcot Spinning Mills Limited ('ESML' or 'the Company') was incorporated in 1988 as a public limited company.

Background ESML is associated with Nagina Group since its inception. Over the period, the Group has managed to grow from a single Spinning company to multiple spinning entities and a weaving company.

Operations ESML has 79,200 operating spindles with a yarn production capacity of approximately 16.5 mln kgs. based on 18/s count. The Company has a total energy requirement of 8.33MW (Mega Watt), primarily met through gas generators. ESML has already installed a 1MW solar power plant and is in the process of installing an additional 1.4MW. The Company's manufacturing facility is located in District Kasur, Punjab.

Ownership

Ownership Structure ESML is majorly (~71%) owned by Nagina Group, through group companies and sponsoring individuals mainly Mr. Raza Ellahi Shaikh (12.79%) and Mr. Amin Ellahi Shaikh (12.79%).The remaining stake of the Company rests with financial institutions (~23.21%) and the general public (~5.85%).

Stability The considerable positions in the Nagina Group are held by the Ellahi Family. The Group has a structured line of succession like in ESML, Mr. Raza Ellahi Shaikh, Mr. Amin Shahzada Ellahi Shaikh act as non-executive directors and Mr. Haroon Ellahi Shaikh as executive director. However, the transfer of ownership to the next generation is yet to be seen.

Business Acumen Nagina Group is one of the oldest medium-sized textile houses in Pakistan. Operating under Ellahi Family for five decades, developing credential expertise in spinning and weaving over a period of time. The Group has adequately expanded its capacities despite the competitive textile industry.

Financial Strength Nagina Group comprises three listed public limited companies, namely; i) Ellcot Spinning Mills Limited, ii) Prosperity Weaving Mills Limited (PWML), and iii) Nagina Cotton Mills Limited (NCML) and six private limited companies i.e., Monell (Pvt.) Limited, Icaro (Pvt.) Limited, Haroon Omer (Pvt.) Limited, Ellahi International (Pvt.) Limited, ARH (Pvt.) Limited, and Pacific Industries (Pvt.) Limited.

Governance

Board Structure ESML's board comprises ten members out of which five members are non-executive and two members occupy executive roles including CEO, while three directors are independent.

Members' Profile Mr. Shahzada Ellahi Shaikh, the Chairman, possesses 47 years of experience in the textile industry and holds a bachelor's degree in Economics and International Relations. Among the other board members, Mr. Shafqat Ellahi Shaikh has 42 years of industry-specific experience and holds a BA in Economics and Religion from Columbia University. Mr. Shaukat Ellahi Shaikh has 45 years of overall experience in the textile industry and holds a bachelor's degree in Economics and Political Science.

Board Effectiveness Three committees: Audit, Executive, and Human Resource & Remuneration, are in place to assist the board in relevant matters and ensure proper oversight. During every quarter of FY24, board meetings were held to discuss current Company performance and update on projected targets. The meeting minutes are documented properly.

Financial Transparency M/s. Rahman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants are the external auditors of the Company. They have expressed an unqualified opinion on the financial statements of the Company for FY23.

Management

Organizational Structure The top-tier management positions of the operating companies within the Nagina Group (NCML, ESML, and PWML) are held by the Ellahi Family. Management control vests with the Ellahi Family with a defined reporting line to ensure smooth operations and excellence. The Company's organizational structure is broadly divided into seven functional departments: (i) Marketing, (ii) Finance, (iii) Accounts, (iv) Administration and corporate, (v) Commercial (fixed asset procurement), (vi) Export, and (vii) Internal Audit.

Management Team Mr. Haroon Shahzada Ellahi Sheikh is CEO of the Company. He is well verse with the textile business and has strong business acumen. He is supported by a team of seasoned professionals, supplementing his expertise. Mr. Shafqat Ellahi Shaikh is the Executive Director. He is associated with ESML Spinning since its inception. He is well verse with the textile business and has strong business acumen.

Effectiveness The management meetings are held on a daily basis with follow-up points to resolve or proactively address operational issues, if any, eventually ensuring a smooth flow of operations. The Company's MIS can be classified into three categories on the basis of periodicity – Daily, Weekly, and Monthly.

MIS The system has been upgraded from the FOXPRO technology to Oracle systems previously implemented. It allows the user to enter loom-wise packed production of produced fabric efficiently. The system includes Bam Wise's Warping, Sizing, Loom, and Folding Processes recording.

Control Environment The Company is accredited with multiple certifications for compliance and quality assurance, namely; ISO 9001:2008, Standard 100 by OEKOTEX, Global Organic Textile Standards (GOTS), Organic Content Standard, Organic Content Standard 100, and Organic Content Standard Blended.

Business Risk

Industry Dynamics The country's textile exports reached USD 15.2bln during 11MFY24 compared to USD 14.7bln in the same corresponding period, indicating a modest growth of ~0.03% on a YoY basis. The global economic slowdown subdued the demand patterns and consumption trends in the international market. The factors affecting the textile industry are escalated energy tariffs and challenges in the procurement of raw materials on account of lower local cotton yield impacting the finished product margins. However, the gradual decline in the interest rates is anticipated to provide comfort to the local industry. A decline in domestic cotton crop production and costly imports could pose supply chain risks.

Relative Position Nagina Group has a long operating history in Pakistan and has developed a prominent position in the local spinning industry. Currently, the Group's spinning capacity strengthens ESML's market position. However, on a standalone basis, ESML's share in the local spinning industry is minimal to none.

Revenues During 9MFY24, revenue grew by 31% to stand at PKR 11,358mln; (9MFY23: PKR 8,633mln, FY23: PKR 12,224mln) on the back of improved prices when compared with the same period last year. The company followed a sales mix dominated by local revenue, whereas exports constituted 13% in 9MFY24 (9MFY23: 13%).

Margins During 9MFY24, gross margin experienced a significant decline (9MFY24: 7.0%; 9MFY23: 8.8%, FY23: 8.5%) on the back of demand shortage of yarn. This translated into detoriated operating margin (9MFY24: 4.8%; 9MFY23: 6.1%, FY23: 5.7%). Net margin also registered a significant decline (9MFY24: 0.5%; 9MFY23: 3.9%, FY23: 0.6%) attributable to reduced gross profit and high finance cost.

Sustainability ESML's business strategy focuses on maintaining an optimal mix of local and export sales while consistently monitoring areas where cost-reduction measures can be implemented to enhance the Company's value through sustainable profit generation and stable market growth. The Company's management is mindful of aligning financial performance with projected topline and profitability. During FY23, the Company completed the execution of CAPEX by installing an additional 16,800 spindles, to cater for incremental market demand.

Financial Risk

Working Capital At end-Mar24, the net working capital cycle reduced to 82 days (FY23: 118 days) owing to decrease in inventory days (9MFY24: 62 days, FY23: 91 days) The Company witnessed significant decrease in trade assets (9MFY24: PKR 3,997mln; FY23: PKR 4,712mln); culminating in higher ST trade leverage adequacy (9MFY24: 95.4%; FY23: 89.8%).

Coverages During 9MFY24, the finance cost increased to stand at PKR 381mln (9MFY23: PKR 128mln, FY23: PKR 189mln). Higher finance cost weakened interest coverage (9MFY24: 2.5x; 9MFY23: 5.3x, FY23: 5.2x) and weakened debt coverage (9MFY24: 1.1x; 9MFY23: 1.5x,FY23: 1.4x). Debt payback reduced to 6.0 years (9MFY23: 6.5 years, FY23: 6.1 years).

Capitalization ESML fulfills its working capital needs through a mix of internal cash flows and short-term borrowing. At end-Mar24, Company's leverage decreased to 50.9% (FY23: 54.7%). The total debt decreased to stand at PKR 4,250mln (FY23: PKR 4,849mln); out of which, short-term borrowing constituted only 1.9%. The equity base of the company increased to stand at PKR 4,107mln (FY23: 4,021mln).

PKR mln

Ellcot Spinning Mills Limited Textile | Spinning	Mar-24 9M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	4,972	5,361	4,082	2,843
2 Investments	627	185	635	721
3 Related Party Exposure	-	-	-	-
4 Current Assets	4,403	5,055	4,664	2,626
a Inventories	*2,140*	*3,027*	*3,053*	*1,455*
b Trade Receivables	*827*	*945*	*1,033*	*639*
5 Total Assets	10,001	10,601	9,380	6,189
6 Current Liabilities	995	1,058	997	701
a Trade Payables	*98*	*75*	*66*	*64*
7 Borrowings	4,250	4,849	3,922	2,628
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	648	673	722	308
10 Net Assets	4,107	4,021	3,739	2,552
11 Shareholders' Equity	4,107	4,021	3,739	2,552
B INCOME STATEMENT				
1 Sales	11,358	12,224	10,873	7,716
a Cost of Good Sold	*(10,559)*	*(11,182)*	*(8,725)*	*(6,316)*
2 Gross Profit	799	1,042	2,149	1,399
a Operating Expenses	(248)	(343)	(302)	(235)
3 Operating Profit	551	699	1,846	1,164
a Non Operating Income or (Expense)	*31*	*62*	*(55)*	*(32)*
4 Profit or (Loss) before Interest and Tax	582	761	1,792	1,132
a Total Finance Cost	*(381)*	*(189)*	*(163)*	*(116)*
b Taxation	*(147)*	*(152)*	*(398)*	*(203)*
6 Net Income Or (Loss)	54	420	1,231	814
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*866*	*901*	*1,940*	*1,309*
b Net Cash from Operating Activities before Working Capital Changes	*462*	*626*	*1,800*	*1,168*
c Changes in Working Capital	*593*	*(220)*	*(1,888)*	*(8)*
1 Net Cash provided by Operating Activities	1,055	406	(89)	1,160
2 Net Cash (Used in) or Available From Investing Activities	(317)	(1,060)	(1,485)	(918)
3 Net Cash (Used in) or Available From Financing Activities	(717)	742	1,589	(232)
4 Net Cash generated or (Used) during the period	20	88	16	10
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	23.9%	12.4%	40.9%	25.4%
b Gross Profit Margin	7.0%	8.5%	19.8%	18.1%
c Net Profit Margin	0.5%	3.4%	11.3%	10.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	12.8%	5.6%	0.5%	16.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	1.8%	10.8%	39.1%	37.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	84	120	104	104
b Net Working Capital (Average Days)	82	118	102	100
c Current Ratio (Current Assets / Current Liabilities)	4.4	4.8	4.7	3.7
3 Coverages				
a EBITDA / Finance Cost	2.9	6.6	14.7	12.7
b FCFO / Finance Cost+CMLTB+Excess STB	1.1	1.4	3.3	2.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	6.0	6.1	1.9	2.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	50.9%	54.7%	51.2%	50.7%
b Interest or Markup Payable (Days)	68.6	234.4	111.0	74.7
c Entity Average Borrowing Rate	9.7%	3.7%	3.8%	3.7%

Credit Rating

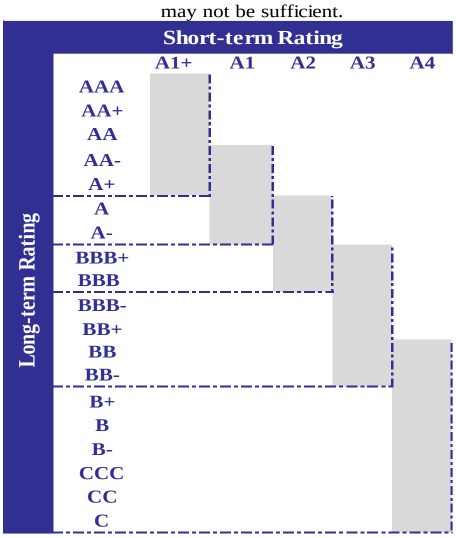
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



The correlation shown is indicative and, in certain cases, may not hold.

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)
Proprietary Information